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ALL THAT THE LAW ALLOWS, BUT MAYBE MORE OR LESS THAN YOU THOUGHT—STATUTORY CONTRACT AND FIDELITY BONDS

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I. INTRODUCTION

Everyone knows the general rule that surety bonds and fidelity/bank insurance are contracts, entered into by parties just like any other contracts, and subject to all of the rules applicable to contracts of all types. Because the surety or insurer drafts or issues the bond or policy, ambiguities are construed against that surety or insurer. Unambiguous terms and provisions are not construed but simply applied as written. The cardinal rule is to read the bond or policy to determine how it is to be enforced. At least, that is the theory.

What if the bond or policy was bought by the obligee or insured in order to comply with or satisfy the requirements of a statute? Perhaps the instrument even says so on its face, or perhaps it has conditional language ("When this bond has been furnished to comply with a statutory or other legal requirement . . ."). In such cases, merely reading the four corners of the document is not enough and can be seriously misleading. Courts do not treat statutory bonds and insurance policies the same as other contracts, bonds, or policies. To know the difference, you must determine whether your bond or policy is statutory in the first place.

II. WHAT IS A STATUTORY BOND OR POLICY?

"All bonds may be viewed as falling into one of two categories: 'Statutory' or 'Common Law.' Any bond which is neither required by nor given under a statute or regulation is considered to be a "common law" bond."[1] Unless, then, an obligee, claimant, or insured at least can point to a statute that requires the suretyship or insurance in dispute, the bond or policy clearly will be considered "common law." At the other end of the spectrum, a bond or policy that cites or quotes the statute and states the intent to comply with or satisfy the requirements of that statute (or associated regulations), without any inconsistent provisions, clearly will be statutory in nature and subject to the statutory terms.

In the contract surety context, courts may look to the public or private nature of the project to determine whether the bonds are statutory or common-law bonds.[2] If the property on which the work is to be done is public land and the government is the owner contracting for the work, then the bonds securing performance of the work and payment of the job costs usually will be statutory (assuming such public work must by statute be

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[1] Gary J. Valeriano, "Statutory Fidelity Bonds–Do they Mean what they Say?" Annual Mid-Winter Meeting, Tort & Ins. Practice Section, Fidelity & Surety Law Comm. (ABA 1989).

[2] Patrick J. O'Connor, Jr., "Statutory Bonds or Common-Law Bonds: the Public-Private Dilemma," 29 Tort & Ins. L.J. 77 (ABA 1993).

bonded). This is so even if the bonds make no mention of any statutory provisions or intent to comply with public bonding requirements.[3]

More complicated are those projects mixing public and private involvement, including situations where the government lends its credit or allows a private entity to construct facilities to be owned or managed privately even on public lands. Courts at all levels and for decades have struggled with the impact of government involvement with private lessees, contractors, financiers, *et al*. when the question is whether the project and bonds should be considered public. As long as 65 years ago, the Supreme Court noted that "the question of title to the buildings or improvements or to the land on which they are situated is no longer of primary significance."[4] As recently as November, 2007, a Louisiana federal judge held that a bond issued on an Army Corps of Engineers contract was not statutory even though it was issued on the standard federal form for payment bonds, so the third-tier subcontractor could not recover.[5] Analyzing all of the fact patterns that can influence the determination of public vs. private is the subject of a different paper,[6] but the nature of the project certainly will play a role if the bond itself does not lay the question to rest.

Even when the bond terms refer to or incorporate the requirements of some applicable statute, at least two states analyze the terms of the bond despite the nature of the work or expressed intent. In Florida and Tennessee, a surety bond on an undisputedly public project and expressly stating its intent to comply with statutory requirements nevertheless will be construed as a common-law bond if it contains terms going beyond the statute.[7] In those jurisdictions, determining the nature of the bond will require comparison of the form to the statutory provisions even after identifying whether or not the project falls within public works.

Insurance policies also may be governed by statutory requirements. In such cases, no contract or project exists to be evaluated for ownership or funding issues. Rather, the mere existence of a statute applicable to the insured may trigger the argument that the policy is statutory insurance. Generally, statutory involvement arises

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[3] *Id.*

[4] *United States* ex rel. *Noland Co. v. Irwin*, 316 U.S. 232, 29 (1942).

[5] *Acro-Tek Communs. v. Comnet, LLC*, 2007 WL 4162873 (E.D. La. 2007).

[6] *See* Patrick J. O'Connor, Jr., "Statutory Bonds or Common-Law Bonds: the Public-Private Dilemma," 29 Tort & Ins. L.J. 77 (ABA 1993).

[7] Gregory P. Brown and Andy L. Anderson, "Perils and Promise of Common Law Bonds—Limiting the Scope of Eligible Payment Bond Claims"; 14th Annual Southern Surety & Fidelity Claims Conference (2004). *See also Wal-Board Supply Co. v. Daniels*, 629 S.W.2d 686 (Tenn. Ct. App. 1981) (bond stated that it was to assure payment to those protected by public works statutes "and also independently of said Statutes"; held that broader scope deprived the surety of the statutory notice requirements); *Fla. Keys Commun. College v. Ins. Co. of N.A.*, 456 So. 2d 1250 (Fla. App. 1984) (any public bond going beyond the statute's requirements is a common law bond).

when insurance is allowed to substitute for statutorily mandated surety bonds. The two most common examples are financial institution bonds as substitutes for banker's or broker's surety bonds, and fidelity coverages such as the commercial crime policy standing in for federal ERISA fiduciary bonding requirements.

In states requiring bank officers to be bonded, FIB insurers market their policies as satisfying that statutory duty. The FIB, however, contains numerous conditions, definitions, coverage restrictions, limitations, and exclusions that do not appear in any state's statutes governing banker's bonds.[8] The standard forms also do not contain language referencing or incorporating any banker's bonding statutes. Nevertheless, as will be seen in the cases below, courts have come down on both sides of the question when asked to enforce the FIB in accordance with statutory requirements that differ from its terms.

With limited exceptions, a fiduciary who may have control over the assets of a plan governed by ERISA must obtain a fiduciary bond to protect the plan against loss by reason of acts of fraud or dishonesty by the administrator.[9] Fidelity insurance frequently is used to satisfy this requirement, often by rider including the plan as a named insured and expressly referencing the ERISA bond requirement.[10] As with state banker's bonding laws, ERISA mandates bonding requirements that do not appear in fidelity policies, which themselves facially differ in scope of coverage from ERISA and its regulations. What little case law exists has not yet resolved this question.[11]

Beyond the realms of public construction contract bonding, banker's insurance, and ERISA lie a host of statutory bonds to be construed, applied, and enforced. The following is a representative list of the bonds subject to statutory entanglements.

Medicare and Medicaid Bonds – Providers of home health care, rehabilitation services, and durable medical equipment must furnish a bond as a condition of participation in Medicare or Medicaid programs.[12]

Workers Compensation Self-Insurance Surety Bonds –An employer approved to become self-insured is required to provide security in the form and amount required by

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[8] *See* Sam H. Poteet, Jr. and H. Rowan Leathers, III, "Financial Institution Bond, Standard Form 24—Common Law or Statutory Bond?"; 3rd Annual Southern Surety & Fidelity Claims Conference (1992).

[9] ERISA § 412; 29 U.S.C. § 1112(a).

[10] Gregory R. Veal, "Covering the Plan Trustee: Your Bond Versus the Regs"; 18th Annual Southern Surety & Fidelity Claims Conference (2007).

[11] *Id.*

[12] Edward G. Gallagher, *Medicare and Medicaid Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001); 63 Fed. Reg. 292.

the state to cover future liabilities for payment of workers compensation benefits. Surety bonds are an accepted form of security.[13]

Subdivision Bonds – A public agency may require that a developer post a subdivision, developers, or plat bond before issuing a subdivision map.[14]

Probate Bonds – A bond may be required by statute, will, or the court on its own initiative, or upon request by a party in interest or creditor. The bond is typically conditioned on the faithful discharge by the fiduciary of all duties according to law.[15]

Bankruptcy Trustee/Receiver Bonds – written for entities who have been appointed by the court to act as a receiver or a bankruptcy trustee. Federal law describes the duties of a trustee at 11 U.S.C. § 322. A receiver's duties generally are not statutorily prescribed, but the bonds tend to be "faithful performance" types.[16]

Public Official Bonds – Federal, state, county, and municipal officials of all kinds must be bonded to ensure that the official will faithfully perform the duties of his or her office.[17]

Reclamation Bonds – provide protection against environmental degradation resulting from activities like coal mining and the creation of landfills.[18]

Bail Bonds – defendant's bail is posted for a price. The defendant is released but must appear, else the court declares the bond forfeited and the bonding company must pay. Of course, the surety then seeks to locate and collect from the defendant. Commercial bail is regulated in most states as a form of insurance.[19]

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[13] Lawrence Lerner & Sean P. Hamer, *Worker Compensation Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[14] David C. Veis, Joseph C. Glavin, Jr., and Armen Shahinian, *The Law of Developers or Subdivision Bonds,* in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[15] James A. Knox & Matthew Horowitz, *Probate Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[16] Chad L. Schexnayder, *Bankruptcy Trustee/Receiver Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[17] James A. Knox, *Public Official Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[18] David L. Kinsella, *Reclamation Bonds,* in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001); 30 U.S.C. § 1202 (The Surface Mining Control and Reclamation Act); 42 U.S.C § 6902 (The Resource Conservation and Recovery Act).

[19] Jerry W. Watson & L. Jay Labe, *Bail Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

License and Permit Bonds – required for procurement of licenses and permits. Motor vehicle dealers, slaughterhouses, and shooting gallery operators are examples of entities that must be bonded to get a permit or license.[20]

Mechanics' and Materialman's Lien Discharge Bonds – Most states allow an owner or other interested person to remove a mechanics' or materialman's lien from real property by providing a lien discharge bond in favor of the lien claimant.[21] The bond form may be subject to court or clerk approval as a condition to acceptance for recording.

Fringe Benefit Bonds – an employer may be required to post a bond to secure its obligation to make certain employee fringe benefit contributions.[22]

Internal Revenue Excise Bonds – put in place to ensure payment of taxes on the operations of companies that produce goods and also at the sales and distribution levels.[23]

Immigrant Bonds – encompass "delivery bond," conditioned on the voluntary departure of the alien, and bonds conditioned on the alien's not becoming a public charge.[24]

Judicial Bonds – bonds which either a plaintiff or a defendant may be required to post in civil litigation.[25]

Admiralty/Maritime Bonds – In cases of arrest and attachment, the property may be released by the posting of a bond.[26]

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[20] Patrick Q. Hustead, *License and Permit Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[21] Jonathan J. Dunn, *Mechanics' Lien Discharge Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[22] Anne L Meyers & Ronald P. Friedberg, *Fringe Benefit Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[23] Elsie Bennett Kappler, *Internal Revenue Excise Bonds—The Cost of Vice*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[24] Steven H. Rittmaster, *Immigrant Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[25] L. Franklin Elmore & Mason A. Goldsmith, Jr., *Judicial Bonds,* in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[26] Simon Harter & Eugene R. Preaus, *Admirality and Maritime Law: The Use of Bonds and Other Security Devices in the Legal Framework of International Shipping*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

Lost Instrument Bonds – a type of indemnity bond that ensures that the issuer of an instrument is not subject to risk based on the owner's loss of that instrument. The bond will protect that party in the event the instrument is found by a *bona fide* purchaser.[27]

Notary Bonds – posted to protect the interests of the public in the jurisdiction in which the notarial commission has been issued.[28]

Warehouse Bonds – conditioned upon the faithful performance of the warehouseman's obligations, particularly redelivery of goods on demand.[29]

III. CONSTRUCTION OF STATUTORY BONDS AND INSURANCE

What is the effect of determining that the fidelity or surety bond is "statutory?" If the bond form tracks the statutory language perfectly, there may be no effect at all. If the bond differs, though, then the answer depends on the jurisdiction. The main alternatives include (a) "reading in" the terms of the statute and "reading out" any other terms of the bond, and (b) "reading in" the statutory requirements but keeping other bond provisions deemed not inconsistent with those requirements. Of course, the courts are always finding interesting variations on the primary alternatives.

A. Read-In/Read-Out

In some states the interpretation and application of the bond is governed by the provisions of the statute without regard to different bond terms. This rule of construction has been called the "read-in/read-out rule." As stated by the Georgia Supreme Court, "Whatever is included in the bond, and is not required by law, must be read out of [the bond], and whatever is not expressed, and ought to have been incorporated, must be read as if inserted into [the bond]."[30]

States adopting the read-in/read-out rule have treated any additional conditions set forth in the bond, even if they expand the liability of the surety, as unenforceable "surplusage."[31] For example, a federal bankruptcy court in Michigan has stated that language inconsistent with the statute is to be redacted from the bond and is

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[27] Michelle I. Rieger, *Lost Instrument Bonds,* in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[28] Jay H. Kern & Patricia M. Crowley, *Notary Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[29] Maria Charles McGuinness, *Warehouse Bonds*, in THE LAW OF MISCELLANEOUS AND COMMERCIAL SURETY BONDS (Todd C. Kazlow & Bruce C. King, eds., 2001).

[30] *Campbell v. Benton*, 122 S.E.2d 223, 226 (Ga. 1961).

[31] *Kansas Bankers Sur. Co. v. Farmers State Bank,* 408 F. Supp. 2d 751 (S.D. Iowa 2005).

nonbinding.[32] Likewise, an Arizona court has rejected the argument of a claimant that a statute—including an amendment subsequent to issuance of the bond—may not narrow the bond's scope.[33] Claimants may be surprised to learn that they cannot rely on the language of the statutory bonds in these jurisdictions, because different provisions in the governing statute, even if favoring the surety, override the bond's terms. Maryland, New Mexico, West Virginia, Iowa, Louisiana, Alabama, Kansas, and Missouri also have adopted the read-in/read-out approach.[34]

For example, in *Water Works, Gas & Sewer Board of City of Oneonta, Inc., v. P.A. Buchanan Contracting Co.*,[35] a natural gas pipeline exploded 16 years post installation. A property owner sustained damage to his building and sued the city. The city sought to implead the contractor's surety under its performance bond. As a statutory bond, the surety would not be liable over to the city on a third-party claim. Therefore, the city asserted that the bond was a common-law bond.

The court held that the bond undisputedly was given pursuant to Alabama's Public Works Act. "The bond shows on its face that it was executed in compliance with the statute, and the court is authorized to read into it the provisions of the statute 'and give it the form and effect the statute contemplated, regardless of its contents.'"[36] Regardless of the form of the bond or the construction contract incorporated in it, its statutory nature restricted the surety's liability to that provided in the statute.

In *Gloucester City Board of Education v. American Arbitration Association*,[37] principal and surety submitted a standard AIA A312 performance bond on a public project subject to the statutory requirement to use the state's specified Little Miller Act

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[32] In re *Mayville Feed & Grain, Inc.*, 96 B.R. 755 (Bkrtcy. E.D. Mich.,1989). *But see Joba Construction Co. v. V&Y Construction Svcs., Inc.*, No. 263258, 2005 WL 3078190 (Mich. Ct. App. Nov. 17, 2005) (surety may contract for greater liability than provided in statute; 90-day notice requirement in bond enforced despite 30-day period in statute).

[33] *Brown Wholesale Elec. Co. v. Merchants Mut. Bonding Co.,* 713 P.2d 291 (Ariz. App. 1984).

[34] *See Water Works, Gas & Sewer Bd. of City of Oneonta, Inc. v. P.A. Buchanan Contracting Co.*, 318 So. 2d 267 (Ala. 1975); *United States Fid. & Guar. Co. v. Christoffel*, 566 P.2d 308 (Ariz. App. 1977); *Kansas Bankers Sur. Co. v. Farmers State Bank*, 408 F. Supp. 2d 751 (S.D. Iowa 2005); *Hartford Cas. Ins. Co. v. Credit Union 1 of Kansas*, 992 P.2d 800 (Kan. 1999); *Construction Materials v. American Fid. Fire Ins. Co.*, 383 So. 2d 1291 (La. App. 1980); *Westinghouse Electric v. Minnix*, 269 A.2d 580 (Md. 1970); *City of Manton v. Ryder*, 417 N.W.2d 257 (Mich. App. 1987); *Pipe Systems, Inc. v. American Mfrs. Mut. Ins. Co.*, 609 F. Supp. 571 (D. Mo. 1985); *State v. Romero*, 160 P.3d 914 (N.M. 2007); *Tug River Lumber Co. v. Smithey*, 148 S.E. 850 (W. Va. 1929). Iowa is a special case, because the question has not been decided by the state courts and the federal courts have stated the rule and then applied it lightly. *See First Am. State Bank v. Continental Ins. Co.,* 897 F.2d 319 (8th 1990) (Iowa law; potential income exclusion enforced in statutory banker's bond despite no correlating language in statute).

[35] 318 So. 2d 267 (Ala. 1975).

[36] *Id.* at 269 (*quoting American Cas. Co. v. Devine*, 157 So. 2d 661 (Ala. 1963)).

[37] 755 A.2d 1256 (N.J. Super. A.D. 2000).

bond form. The A312 form added several provisions not present in the statute or statutory form and had a "savings clause" stating that any such provision conflicting with the statute would be replaced by what the statute required. The surety attempted to enforce the bond form's conditions of declaration of default, termination, and action on the bond within six months, but the court refused. Appearing to apply the read-in/read-out rule, the court would not allow the surety to narrow its liability based on any bond provision that was not contained in the statute.[38]

The read-in/read-out rule can induce careful consideration of the statute, regulations, and legislative history when a court attempts to apply the bond or policy. In *Skirlick v. Fidelity & Deposit Company of Md.*,[39] union members sought to recover damages from the union's statutory fidelity insurer after officers' actions in declaring an arguably illegal strike led to discharge of the members. The court parsed the language and history of the statute that required bonding or insurance against fraud or dishonesty, which the F&D policy covered. The court then concluded that any loss resulted from conduct more in the nature of a faithful-performance breach and therefore was not covered.[40]

Another effect of the read-in/read-out rule may be to restrict creative arguments for expanding coverage under the bond beyond that provided in the statute. In *Accerbi v. Hartford Fire Ins. Co.*,[41] Hartford pointed out that the protection offered by its bond, issued under the Georgia Residential Mortgage Act, was limited to only those transactions involving residential property. Because the subject property was commercial, Hartford contended that its bond did not provide protection to Ms. Accerbi for the fraudulent conduct of her broker.

The plaintiff claimed that the protection of the bond nevertheless was invoked because her broker, the principal, represented the loan as a residential transaction by telling lenders that the property was residential and by using residential mortgage documents in the sham closing. Thus, she contended, the principal's conduct precluded Hartford from disavowing the residential nature of the transaction. Under Georgia's read-in/read-out rule, however, the court found that the statute governed and that

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[38] *Id.* at 1264-1265. The ruling was silent on the question of whether the read-in/read-out rule could work in the surety's favor if the nonconforming bond actually expanded the surety's liability beyond the statutory requirements.

[39] 852 F.2d 1376 (D.C. Cir. 1988).

[40] *Id.* at 1378-1380. The court noted that Congress had removed faithful-performance coverage from the requirements in the statute. Interestingly, the court opened by noting that "there is no federal legislative standard for bonds 'executed under any law of the United States' so we look to state law bond provisions and construction for guidance." *Id.* Looking to the laws of Maryland and the District of Columbia as possible fora, the court found both consistent in interpreting insurance contracts and apparently applied general common-law rules of construction.

[41] 2005 WL 2406150 (S.D. Ga. 2005).

extrinsic conduct by the principal could not extend the coverage of the bond beyond what the statute provided.

In In re *Kemper Insurance Companies*,[42] the insurer issued its workers compensation self-insurance bond on a form approved by the state board with the expressed intention of covering the employer to the extent required by statute. The issue was that the bond, with stated effective dates from September 1, 2000 until September 1, 2001, also said that it covered all of Kemper's "past, present, existing, and potential liability" for workers compensation payments regardless of the date of injury.[43] The statute required the latter language but said nothing about effective dates (although they were in the board-approved bond form).

The court carefully examined the language of the bond and essentially concluded that the intent of the statute overrode the insurer's stated effective dates. The dissent noted that a more reasonable reading of the bond language would have restricted the insurer's liability to payments not made by Kemper during the effective dates of the bond (and the longer period triggered by the insurer's acceptance of a second premium), but the majority read out the "effectiveness" of the effective dates.[44]

Ruling against the fidelity insurer of an escrow agent, the Washington Supreme Court held that a statutory policy expressly covering only the insured's loss nevertheless permitted recovery by a third-party assignee of a "loss." In addition, the court allowed recovery even though the transaction was merely a shifting of funds from an escrow account into an operating account—both controlled by the agent.[45] When the third party, whose funds had been shifted and then used by the agent, sought recovery of the insured's loss, the court of appeals denied the claim because the assignor-agent had incurred no loss.[46]

The supreme court reversed, relying heavily on its reading of the statute under which the policy was issued. "Furthermore, in interpreting a statutory bond, we consider *all* of the provisions of the relevant statute. Therefore, we consider all of the provisions of the Escrow Agent Registration Act in determining what 'loss' the statutorily mandated bond covers. When read in its entirety, the Act reflects a legislative intent to protect clients of escrow agents."[47] After such a statement, the court's holding that a covered

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[42] 819 N.E.2d 485 (Ind. Ct. App. 2004).

[43] *Id.* at 492-493.

[44] *Id.* at 495-496.

[45] *Est. of Jordan by Jordan v. Hartford Acc. & Indem.*, 844 P.2d 403 (Wash. 1993).

[46] *Est. of Jordan by Jordan v. Hartford Acc. & Indem.*, 813 P.2d 1279 (Wash. App. 1991).

[47] *Est. of Jordan*, 844 P.2d at 408.

loss occurred—despite the policy's requirement that the insured escrow agent incur the loss—was no surprise.

The Washington court of appeals further demonstrated how the read-in/read-out rule operates to affect the same statutory escrow agent's bond in *Commonwealth Land Title Insurance Co. v. Gulf Underwriters Insurance Co.*[48] The statute permitted a commercial blanket bond to substitute for the required surety bond and even allowed the insurer to define the "officers and employees" who would be covered. Gulf's policy excluded "owners" from coverage. The statute's general purpose, though, as noted in *Estate of Jordan by Jordan*,[49] is to protect members of the public using the escrow agent. The plaintiff title company, asserting rights by assignment, argued that these two parts of the statute are in conflict so that the insurer's exclusion of "owners" should be read out.

The court acknowledged the conflict but resolved it by noting that the assignee title company was not a member of the public within the class intended to be protected by the statute. Instead, the title company was a sophisticated business entity that had bargained with the owner of the escrow agency to provide title insurance in return for indemnity. Therefore, the public policy embodied in the statute was not offended by enforcing the insurer's statutory right to exclude owners from the policy's coverage. The court did note, in dicta, that the result would have been different if the plaintiff had been a customer of the escrow agency.[50]

B. READ-IN/READ-OUT PLUS

A number of jurisdictions go beyond reading in the statutory terms and reading out anything else as surplusage. They are willing to allow the bond or policy to affect the scope of coverage within the courts' varying views of the statutory intent. Sometimes, this version of "read-in/read-out plus" is said to allow the surety or insurer to expand but not restrict the coverage provided under the statute. For example, under Illinois' Little Miller Act, the court held, "Although the express provisions of the statute are deemed to be contained in every bond for a public construction project, whether actually inserted in the bond or not, the contractor and its surety are free to contract with the public entity for additional liability which exceeds the statutory provisions." *Aluma Systems, Inc. v. Frederick Quinn Corp.*[51] In that case, however, the bond expressly

[48] 91 Wash. App. 1013, 1998 WL 283510 (1998).

[49] 844 P.2d 403, 408, *supra* at nn. 43 & 45.

[50] *Id.* at *3.

[51] 564 N.E.2d 1280, 1297-98 (Ill. App. 1990). *Cf. William J. Templeman Co. v. United States Fid. & Guar. Co.*, 739 N.E.2d 883 (Ill. App. 2000) (statute's requirement that all claimants give surety notice was overwritten by bond's exemption of privity claimants, so that assignee of subcontractor's claim was not required to provide notice otherwise required by statute). *See also Gibson v. State*, 655 P.2d 1028 (Okla. 1982) (bail bond's language, broader than that required by statute, enforced as written); *Joba Construction Co. v. V&Y Constr. Svcs., Inc.*, No. 263258, 2005 WL 3078190 (Mich. Ct. App. Nov. 17, 2005).

limited its coverage scope to that provided by statute, so that the claimant received no greater benefit.

Likewise, Tennessee imposes on the surety anything provided in the bond that goes beyond the coverage required by statute. Those courts have held that, where the Little Miller Act bond expressly references the statutes and amendments but goes on to provide coverage "independently of said Statutes," the surety has elected by the terms of its bond to extend protection under less stringent rules and is bound by the terms of its bond.[52] Florida goes further in construing its "common-law bonds" so that the surety not only must provide coverage to the full extent stated in the bond but also may not rely on consistent statutory restrictions, such as the statute of limitations applicable to public works bonds.[53]

Indiana has approached bond variances from the statute with a twist. Where the bond is issued to comply with the state's Little Miller Act but expressly covers claimants who would not be protected under the act, the two classes of claimants receive different scopes of protection. In *Dow-Par, Inc. v. Lee Corp.*,[54] the statute did not cover equipment lessors, but the bond did. Looking to jurisdictions such as Tennessee, Florida, and Missouri for general guidance, the court held that the bond provided only the statutory benefits to claimants specified in the statute but also extended the bond's protection beyond the statutory scope as to other claimants. In that case, the bond covered the lessor as a proper claimant, but the restrictive language in the bond also barred recovery.[55]

A statutory contractor's license bond became, according to the Nevada Supreme Court, a labor and materialmen's bond under the holding in *Royal Indemnity Co. v. Special Service Supply Co.*[56] The licensing statute required a bond conditioned to pay for the contractor's "wrongful act or omission," while the bond, in its recitation of effective dates, stated that the surety "shall in no event be liable for labor and material bills incurred by the principal prior to the date hereof."[57] Without actually deciding the

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[52] *See Anthony v. Construction Prods., Inc.,* 677 S.W.2d 4 (Tenn. App. 1984); *Wal-Board Supply Co., Inc. v. Daniels*, 629 S.W.2d 686 (Tenn. App. 1981); *Hogan v. Walsh & Wells, Inc.,* 177 S.W.2d 835 (Tenn. App. 1944).

[53] *See Fla. Keys Commun. College v. Ins. Co. of N.A.*, 456 So. 2d 1250 (Fla. App. 1984) (any public bond going beyond the statute's requirements is a common law bond, as to which four-year statute—not one-year statute on public works bonds—applies). *See also Travelers Indem. Co. v. Housing Auth. of City of Miami*, 256 So. 2d 230 (Fla. App. 1972).

[54] 644 N.E.2d 150, 155-156 (Ind. App. 1995).

[55] *Id*. The court read the bond to reduce the penal sum to the extent of payments made by the principal to the subcontractor who had not paid the equipment lessor. Because the contractor had paid or incurred more than the penal sum of the bond, no amount remained for payment to the lessor.

[56] 413 P.2d 500 (Nev. 1966).

[57] *Id.* at 501.

scope of coverage under the statute, the court concluded that the bond's language carried the necessary implication that the surety would be liable for labor and materials bills incurred by the principal *after* the date of the bond.

The federal courts have applied the "read-in/read-out plus" approach. In *American Casualty Co. v. Irvin*,[58] the surety bond issued under the federal Packers and Stockyards Act provided that 30-day's notice of cancellation was waived if the bond was replaced only by the same surety; the regulations under the statute waived notice of cancellation if the bond were replaced by any surety. When the surety changed and losses overlapped the 30-day period after the change, American Casualty sought the protection of the statute. The Fifth Circuit held that American Casualty had expanded the protection of the bond and was liable for losses during the 30-day period. Had the bond been silent or consistent with the statute, the result would have favored the surety.[59]

In a more recent Miller Act case, the district court construed nonconforming bonds in light of the remedial and thus liberal purposes of the statute to hold the surety liable even where the evidence clearly showed that the claimants' scope of work was not intended to be covered. In United States *for the use of Sheet Metal Engineering, Inc. v. Job Shops, Inc.*,[60] the federal contractor and contracting officer agreed that the work and bonds would be phased, and the surety issued bonds to cover only the foundation and structural steel work in the total amount of about $260,000—expressly declining to issue bonds for the balance of the $3.5 million contract phases. The claimants' work was within that large balance of scope, but the court found their claims to be covered nonetheless.

Unfortunately, the bonds referenced "the contract," which included all of the scope without mention of phasing, and the court refused to enforce the written communications by the contracting officer as an informal modification of the contract.[61] Because the surety did not expressly limit the scope of the covered work on the face of the bonds, and the incorporated contract did not do so in writing, the surety was bound for all of the work, but only up to the relatively small total penal sum. By implication, restricting the scope of work covered, even though inconsistent with the Miller Act's requirement of 100% payment and performance bonds, would have provided a defense to the surety.

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[58] 426 F.2d 647, 648 (5th Cir. 1970).

[59] *See also Firemen's Fund Ins. Co. v. Abilene Livestock Auction Co.*, 391 S.W.2d 147 (Tex. Civ. App. 1965) (bond issued under Packers & Stockyards Act to cover transactions in dealer's home city, where he was registered, would be enforced as to transactions in Abilene even though he was not registered there); *Francis v. New Amsterdam Cas. Co.*, 407 S.W.2d 631 (Mo. App. 1966).

[60] 2006 WL 4005634 (S.D. Iowa Dec. 14, 2006).

[61] *Id.*

Another case enforcing bond terms that are not inconsistent with the statute is *Kansas Bankers Surety Co. v. Farmers State Bank*.[62] The financial institution bond insurer sought declaratory judgment in its favor and moved for summary judgment; the bank cross-moved. To defend the "direct loss" and "manifest intent" provisions of the bond, the insurer pointed to a note on the lower left-hand corner of the first page stating: "This is a Fidelity Crime Bond. It is not a faithful performance duty bond or a statutory bond." The bank's president stated, however, that the bank purchased the bond to comply with the requirements of Iowa's bank official's bonding statute.

The court stated that a bond of a type required by statute generally is presumed to have been intended by the parties to comply with those requirements. The court found that the Kansas Bankers bond was such a type in terms of its provisions and in light of the bank president's testimony about the bank's intent, notwithstanding the insurer's express disclaimer on the face of the bond. Finding the bond to be a statutory bond, the court then stated the read-in/read-out rule: coverage required by the statute is read into the bond, and conditions not described by the statute are considered surplusage and read out.[63]

At this point, one would expect the court to have read out of the bond any language that might restrict the coverage desired by the bank and presumably required by the statute. Instead, the court held that "direct loss" and "manifest intent" were not surplusage but in fact were consistent with the statutory requirements that fraud or dishonestly be covered. Based on that conclusion, the court allowed the insurer to assert those provisions (but found factual issues precluding summary judgment).[64]

Standing against this approach is *Indiana Regional Council of Carpenters Pension Trust Fund v. Fidelity & Deposit Co. of Maryland.*[65] A trustee for the pension fund received a large kickback from a real estate agent to vote in favor of using fund assets to buy property for a wildly inflated amount. ERISA mandates that plan trustees be bonded, and the plan obtained a fidelity bond to satisfy this requirement. F&D raised the policy's two-year suit limitation in denying the claim.

ERISA does not contain a statute of limitations, so the court correctly looked to Indiana law. Contractual limitations are enforceable generally in Indiana, but the court somehow decided that the plan's fidelity bond issued under ERISA instead was a public official's bond subject to Indiana law. Indiana cases had held that official's bonds were

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[62] 408 F. Supp. 2d 751 (S.D. Iowa 2005).

[63] *Id.* at 755.

[64] *Id.* at 759. The court followed the similar result and holding in *First Dakota Nat'l Bank v. St. Paul Fire & Marine Ins. Co.*, 2 F.3d 801, 813 (8th Cir. 1993) and *First American State Bank v. Continental Ins. Co.*, 897 F.2d 319 (8th Cir. 1990) (statutory definitions of "dishonesty" and "loss" applied to bond, but potential income exclusion enforced without discussion of consistency with statute).

[65] 2007 WL 683795 (N.D. Ind. 2007).

subject to the Indiana statute of limitations for contracts generally and that an insurer or surety could not vary that statute.[66] The court justified this convoluted logic as follows: ERISA requires that its bonds not violate state law, Indiana's statute of limitations for public official's bonds trumps contractual limitations in those bonds, and the F&D policy was equal to a state public official's bond. The conclusion, however strange, was that the state statute of limitations, not the shorter period specified in the bond, allowed the plan to sue on the bond.[67]

C. POINT/COUNTERPOINT

Here are three instances of different results on the same question, depending on which court was doing the answering and how each viewed the statutory requirements.

The standard trading exclusion was held unenforceable, because it did not appear in the statute under which the policy was issued, in *Index Fund, Inc. v. Insurance Company of America*.[68] The court refused to restrict the insurer's liability for losses resulting from "trading," which was defined to include any buying or selling of securities regardless of any acts or omissions of an employee. The exclusion might well have eliminated coverage that the court determined the statute clearly intended to require.

The same exclusion, however, was enforced in *Lincoln-Way Federal Savings Bank v. Employers Insurance of Wausau*.[69] The court was construing a financial institution bond form equivalent to Standard Form 22, issued in that case to satisfy statutory and regulatory requirements of the Federal Home Loan Bank Board. "This form is expressly approved by the FHLBB under 12 C.F.R. § 563.19. Thus, these exclusions do not run afoul of the FHLBB regulations."[70] This case supports the proposition that even coverage restrictions not contained in the governing statute may be enforceable if a regulating entity has approved the form.

The second example involves the scope of coverage of losses sustained by third parties and not the insured. In *Foster v. National Union Fire Insurance Company of Pittsburgh, PA*,[71] the Eighth Circuit affirmed the trial court's ruling that the Arkansas

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[66] *Id.* at *4-6 (citing *State v. Lidster*, 467 N.E.2d 47, 49 (Ind. Ct. App. 1984)).

[67] *Id.* at *6.

[68] 580 F.2d 1158 (2d Cir. 1978). *See also Research Equity Fund v. Insurance Company of North America*, 602 F.2d 200 (9th Cir. 1979) (exclusion would not have been enforced, but wrongdoer was not even an employee of the insured so that statutory coverage was not mandated).

[69] 717 F. Supp. 617 (N.D. Ill. 1989).

[70] *Id.* at 619. The court also enforced Wausau's loss-sustained endorsement as not being in conflict with the statute or the regs.

[71] 902 F.2d 1316 (8th Cir. 1990).

securities dealers bonding statute required coverage of damages claims brought by third parties. The courts acknowledged that common-law fidelity bonds generally do not cover third-party claims, but a broad interpretation of the statute overrode that general rule. The circuit court said that, while it was not anxious to impose liability where none otherwise existed, it must conform the bond to the coverage required by the statute.[72]

In *School Employees Credit Union v. National Union Fire Insurance Company of Pittsburgh, PA*,[73] both the district court and the Tenth Circuit examined the same Arkansas securities dealers bonding statute and concluded that it did not require coverage of third parties' claims for damages. The district court examined the history of the statute and the first-party nature of fidelity bonds, which generally do not allow third-party claims. The court then concluded that the Arkansas legislature knew what it was doing when it instituted the option for the dealer to obtain fidelity insurance instead of a surety bond. If a dealer posted a surety bond, third parties would have rights; if the limited class of qualified dealers who could obtain fidelity insurance chose to do so, the third parties would be limited to proceeding against those dealers and have the protection of the insurance only indirectly. By that reasoning, both courts enforced the bond's language declining to provide such coverage.

Finally, a straightforward application of the read-in/read-out rule nullified the insurer's automatic-termination-upon-discovery clause in *National Surety Corp. v. Morgan County*.[74] The insurer issued its bond to satisfy the statutory requirement that sheriffs be covered for their revenue-collecting responsibilities, but the bond stated that it automatically terminated upon the insured's discovery of any dishonest act by the sheriff. The evidence raised a question about prior failures to account and dishonesty in repaying amounts which the sheriff had admitted owing. The court would not even consider that evidence, however, because it held that the automatic-termination clause varied from the statute and therefore was unenforceable. Simply because the statute and bond did not track exactly (and the bond provided a defense where the statute on its face did not), the additional language of the bond was read out.[75]

Likewise, in *Mutual Security Life Insurance Co. by Bennett v. Fidelity & Deposit Company of Maryland,*[76] the court asked "[w]hether the automatic termination upon takeover provision in a blanket fidelity bond purchased to satisfy a statutory requirement violates Indiana public policy." Mutual argued that its fidelity bond, mandated by Indiana statute, could not terminate automatically upon takeover of the insured by a trustee or receiver because that would frustrate the state's public policy. F&D countered that the

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[72] *Id.* at 1320.

[73] 52 F.3d 338 [Table], 1995 WL 231370 (10th Cir. 1995).

[74] 440 S.W.2d 791 (Ky. 1969).

[75] *Id.* at 792-793.

[76] 659 N.E.2d 1096 (Ind. App.1995).

statute permits the use of the blanket bond, which was approved in form by the state insurance commissioner, and that the bond language does not conflict with any of the statutory requirements.

The court agreed with F&D. Noting that the governing statute expressly allowed the blanket bond to fulfill the individual bonding requirement, the court found that the state's public policy was consistent with allowing automatic termination upon takeover.[77] Even though the statute did not specifically provide for automatic termination, the state's approval of the form apparently substituted for such a provision. The court's strong interest in enforcing the agreement as made by the parties also played a part in finding the bond's termination-upon-takeover clause to be consistent with the statute.

IV. CONCLUSION

When it comes to statutory bonds and insurance, any of several factors may become dispositive: the language of the statute, regulations, and legislative history, the provisions of the bond or policy, the jurisdiction, and even the court. Determining whether or not a statute governs and what it requires or prohibits may not be easy. Applying "read-in/read-out" will be simpler, but many courts employ some variation of "read-in/read-out plus" with its limited predictability. Looking for regulatory guidance, especially along the lines of approval of the bond or policy form, can be critical. At a minimum, knowing to look beyond the four corners of the document will be a wise start to mastering the difficulties of statutory bonds and policies.[78]

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[77] *Id.* at 1099 (citing Ind. Code § 27-1-7-14).

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